Agenda Item No. 4 (a)

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

9 September 2020

Report of the Director of Finance & ICT

INVESTMENT REPORT

1 Purpose of the Report

To review the Fund's asset allocation, investment activity since the last meeting, long term performance analysis and to seek approval for the investment strategy in the light of recommendations from the Director of Finance & ICT and the Fund's independent adviser.

2 Information and Analysis

(i) Report of the External Adviser

A copy of Mr Fletcher's report, incorporating his view on the global economic position, factual information for global market returns, the performance of the Fund and his recommendations on investment strategy and asset allocation, is attached as Appendix 1.

(ii) Asset Allocation and Recommendations Table

The Fund's latest asset allocation as at 31 July 2020 and the recommendations of the Director of Finance & ICT and Mr Fletcher, in relation to the Fund's strategic asset allocation benchmark, is set out overleaf.

The table also shows the recommendations of the Director of Finance & ICT, adjusted to reflect the impact of future investment commitments. These commitments (existing plus any new commitments recommended in this report) relate to Private Equity, Multi-Asset Credit, Property and Infrastructure and total around £310m (£320m at 30 April 2020). Whilst the timing of drawdowns will be lumpy and difficult to predict, the In-house Investment Management Team (IIMT) believes that these are likely to occur over the next 18 to 36 months.

Asset Category	Benchmark	Fund Allocation	Fund Allocation	Permitted Range	Benchmark Relative Recommendation		Recommendation		Adjusted for Commitments (1)	Benchmark Sterling Return	Benchmark Sterling Return
		30/04/20	31/07/20		AF 9/09/20	DPF 9/09/20	AF 9/09/20	DPF 9/09/20	DPF 9/09/20	3 Months to 30/6/20	3 Months to 31/7/20
Growth Assets	**57.0%**	**53.2%**	**54.6%**	**+/- 8%**	**-**	**(1.0%)**	**57.0%**	**56.0%**	**57.7%**	**n/a**	**n/a**
UK Equities	16.0%	15.8%	15.3%	+/- 4%	-	-	16.0%	16.0%	16.0%	10.2%	1.3%
Overseas Equities:	37.0%	34.2%	36.2%	+/- 6%	-	(0.2%)	37.0%	36.8%	36.8%	n/a	n/a
North America	12.0%	10.6%	11.2%	+/- 4%	-	(1.0%)	12.0%	11.0%	11.0%	21.9%	9.3%
Europe	8.0%	7.8%	8.4%	+/- 3%	-	-	8.0%	8.0%	8.0%	18.8%	11.8%
Japan	5.0%	6.3%	5.6%	+/- 2%	-	+0.6%	5.0%	5.6%	5.6%	12.2%	(0.2%)
Pacific ex-Japan	4.0%	4.6%	4.2%	+/- 2%	-	+0.2%	4.0%	4.2%	4.2%	19.8%	12.4%
Emerging Markets	5.0%	4.3%	4.6%	+/- 2%	-	-	5.0%	5.0%	5.0%	18.9%	13.6%
Global Sustainable	3.0%	0.6%	2.2%	+/- 2%	-	-	3.0%	3.0%	3.0%	19.7%	9.0%
Private Equity	4.0%	3.2%	3.1%	+/- 2%	-	(0.8%)	4.0%	3.2%	4.9%	10.3%	1.5%
Income Assets	**23.0%**	**21.3%**	**20.7%**	**+/- 6%**	**+2.0%**	**(2.0%)**	**25.0%**	**21.0%**	**24.7%**	**n/a**	**n/a**
Multi-Asset Credit	6.0%	6.1%	6.1%	+/- 2%	+2.0%	0.2%	8.0%	6.2%	7.7%	6.5%	6.0%
Infrastructure	8.0%	6.9%	6.8%	+/- 3%	-	(1.0%)	8.0%	7.0%	9.0%	0.6%	0.6%
Direct Property (3)	5.0%	4.9%	4.5%	+/- 2%	+1.0%	(0.5%)	5.0%	4.5%	4.5%	(2.2%)	(2.2%) (2)
Indirect Property (3)	4.0%	3.4%	3.3%	+/- 2%	(1.0%)	(0.7%)	4.0%	3.3%	3.5%	(2.2%)	(2.2%) (2)
Protection Assets	**18.0%**	**18.3%**	**18.1%**	**+/- 5%**	**(2.0%)**	**(0.1%)**	**16.0%**	**17.9%**	**17.9%**	**n/a**	**n/a**
Conventional Bonds	6.0%	5.8%	5.5%	+/- 2%	(3.0%)	(0.5%)	3.0%	5.5%	5.5%	2.5%	(0.1%)
Index-Linked Bonds	6.0%	6.2%	6.2%	+/- 2%	-	-	6.0%	6.0%	6.0%	10.3%	6.0%
Corporate Bonds	6.0%	6.3%	6.4%	+/- 2%	+1.0%	+0.4%	7.0%	6.4%	6.4%	8.5%	5.1%
Cash	**2.0%**	**7.2%**	**6.6%**	**0 – 8%**	**-**	**+3.1%**	**2.0%**	**5.1%**	**(0.3%)**	**0.0%**	**0.0%**

Total Investment Assets totaled £5,142m at 31 July 2020.
(1) Recommendations adjusted for investment commitments at 31 July 2020 and presumes all commitments are funded from cash.
(2) Benchmark Return for the three months to 30 June 2020.
(3) The maximum permitted range in respect of Property is +/- 3%.

The table above reflects the following three categorisations:

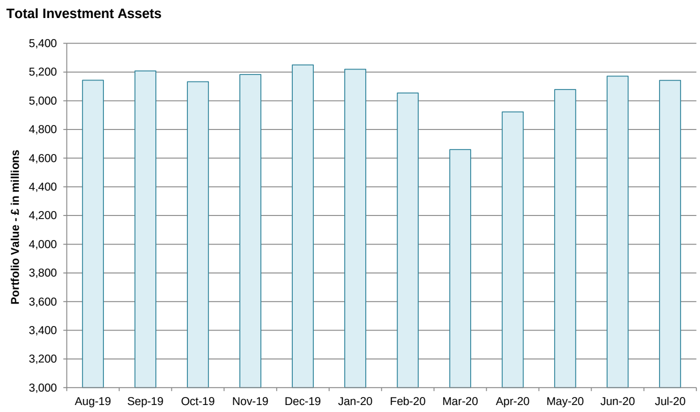
- **Growth Assets**: largely equities plus other volatile higher return assets such as private equity;
- **Income Assets**: assets which are designed to deliver an excess return, but with more stable return patterns than Growth Assets because income represents a large proportion of the total return of these assets; and
- **Protection Assets**: lower risk government or investment grade bonds.

Relative to the benchmark, the Fund as at 31 July 2020, was overweight in Protection Assets and Cash, and underweight in Growth Assets and Income Assets.

If all of the Fund's commitments (existing plus any new commitments recommended in this report) were drawn-down, the cash balance would reduce by 6.0% to -0.3%. However, in practice as these commitments are drawn-down, they will be partly offset by new net cash inflows from investment income, distributions from existing investments and changes in the wider asset allocation.

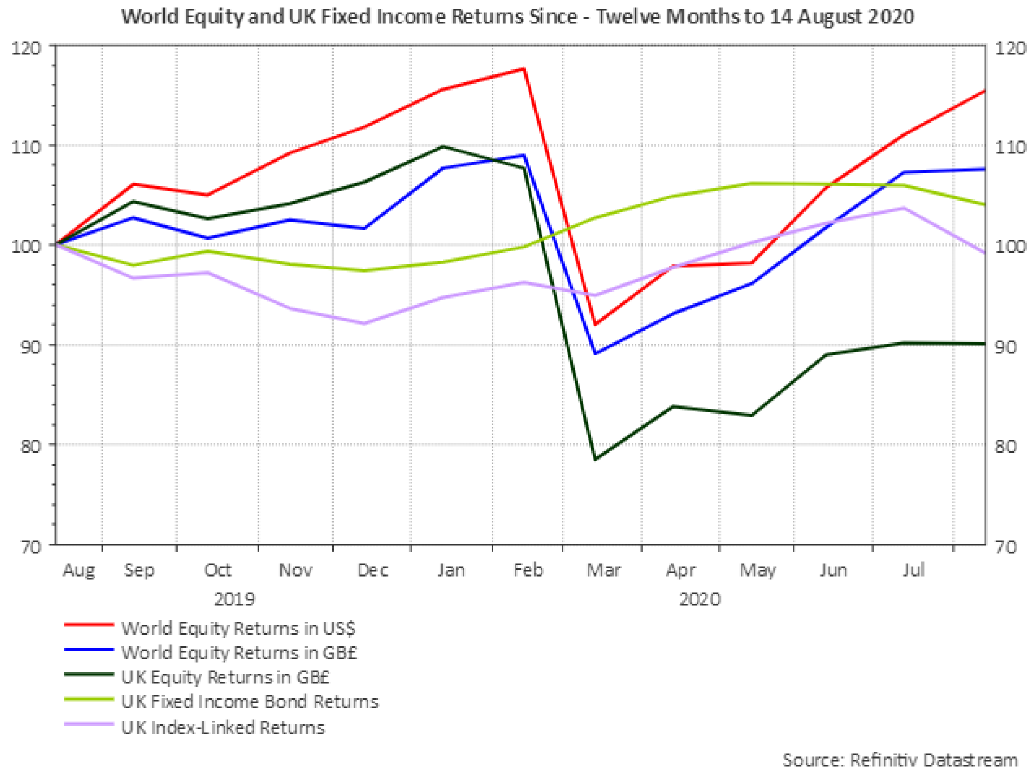
(iii) Total Investment Assets

The value of the Fund's investment assets increased by £219m (+4.5%) between 30 April 2020 and 31 July 2020 to £5.142bn, comprising a non-cash market gain of around £200m, and cash inflows from dealing with members & investment income of around £20m. Over the twelve months to 31 July 2020, the value of the Fund's investment assets has fallen by £32m (-0.6%), comprising a non-cash market loss of around £190m, partly offset by an advance contribution of £58m and cash inflows from dealing with members & investment income of around £100m. A copy of the Fund's valuation is attached at Appendix 2.



The Fund's valuation can fluctuate significantly in the short term, reflecting market conditions, and supports the Fund's strategy of focusing on the long term.

(iv) Market returns over the last 12 months



The chart above shows market returns for Global Equities in Sterling and the US dollar, UK Equities, UK Fixed Income and UK Index Linked bonds for the twelve months to 14 August 2020.

Q2 2020 was a very strong quarter for equities and credit as central banks and governments acted quickly to provide unprecedented levels of stimulus and economies started to reopen. Despite the strong rebound in risk assets, sovereign bonds held up well.

As economies started to reopen, economic indicators improved, supported by the willingness of central banks to keep government and corporate borrowing costs low. For example, the policy measures taken by the UK government included a Coronavirus Job Retention Scheme, tax deferrals, business grants and loan guarantees. UK borrowings are now likely to exceed 15% of national income, or over £300bn, in 2020-21; the biggest deficit since World War II. The worst case scenario of the Covid19 pandemic causing a liquidity crisis was avoided.

The FTSE All World Index in US dollar terms recovered the vast majority of the losses reported across February and March 2020, and in the year to 14 August 2020 provided a positive total return of 16.8%. The return for sterling investors was lower at 9.0% as the pound strengthened against the US dollar; safe haven demand for the US dollar fell in Q2 2020, and US real yields (nominal yield less the rate of inflation) fell compared to the wider market.

Despite a significant fall in US Q2 2020 GDP (annualised fall of 32.9%; around 10% quarter-on-quarter decline (qoq)), and an increase in the number of Covid 19 new infections from mid-June 2020, US equities returned +13.8% in local currency terms in the three months to 31 July 2020 (+2.9% year to date (YTD)). Markets chose to look through the economic data and focus on the economic recovery, the ongoing fiscal and monetary support, and positive news about the development of several vaccines; it is too early to say whether these vaccines will be successful and receive full regulatory approval. Sector performance varied significantly. For example, online retailers performed strongly, whereas traditional high-street retailers underperformed, along with other sectors that have been most affected by the Covid 19 pandemic, such as travel and leisure. Quality significantly outperformed value.

Asia Pacific Ex-Japan and Emerging Market equities were the strongest performing regions in local currency terms in the three months to 31 July 2020, returning +17.0% and +18.2%, respectively, reflecting a weaker dollar (+1.4% and -2.1% YTD).

UK equities were one of the worst performing regions in the three months to 31 July 2020, returning +1.3% (-20.5% YTD). The UK went into recession in Q2 2020, with Q2 2020 GDP falling by 20.4% (qoq), significantly higher than many other developed markets, driven by a sharp fall in consumer spending, and the dominance of the UK service sector which was hard hit by the Covid19 pandemic. Brexit uncertainty also continued to weigh on investor confidence and business investment.

UK sovereign bonds held YTD gains despite the sharp recovery in equity markets. UK Gilts returned -0.1% in the three months to 31 July 2020, whereas UK Index-Linked bonds returned 6.0% as the significant rise in Quantitative Easing (central bank purchases of bonds) and stagflation fears (stagnant economic activity coupled with higher inflation) pushed up inflation expectations. G7 yields remain near historic lows, consistent with expectations for a prolonged period of zero-or-below policy rates in response to the economic backdrop.

Investment grade and non-investment grade (i.e. high-yield bonds) credit also rallied, as credit spreads narrowed, following the US Federal Reserve's announcement that it would purchase investment grade bonds and 'fallen angels' (i.e. investment grade bonds downgraded to high yield status) to support credit markets. Credit spreads are now closer to these immediately prior to the Covid19 pandemic.

The IIMT note that while markets have rebounded sharply since the lows of March 2020, the recovery is heavily dependent on continued fiscal and monetary stimulus, and the assumption that the number of new cases can be controlled without the need for further national lockdowns. Whilst it appears that the number of new cases has been brought under control in much of Asia and Europe, there continues to be regional outbreaks, and the number of new cases in the USA is an ongoing concern. Furthermore, new cases are rising in several emerging markets, including India and much of Latin America. The economic recovery may take several years, with countries emerging from the Covid 19 pandemic at different rates. The longer it takes for activity to return to normal, the longer the potential for long-term economic damage.

Political risk also remains, with the US election fast approaching, tensions between the USA and China escalating (UK relations with China have also deteriorated), and Brexit uncertainty continuing as trade negotiations between the UK and European Union appear to make little progress.

Capital Economics note that whilst there has been an encouraging initial rapid pick-up in economic activity, households and firms remain in cautious mode, preventing a full V-shaped recovery. While policy is set to remain supportive, the recent huge stimulus must ultimately be wound down with likely adverse effects. Capital Economics believe that after shrinking by around 4.5% this year, the world economy will be over 3% smaller than it would have been without the coronavirus outbreak by the end of 2022. The recovery will be uneven, with China, Korea and Taiwan amongst those furthest along the road to recovery, while economies in southern Europe, Latin America and Africa will lag behind.

It is also notable that the International Monetary Fund (IMF) has downgraded its global growth forecasts for 2020 from -3.0% in April 2020 to -4.9% in June 2020 (-8.0% advanced economies / -3.0% emerging markets). The IMF forecast that global growth will pick-up to +5.4% in 2021, but by the end of 2021, the global economy will still be 6.6% smaller than forecast before the start of the Covid 19 pandemic.

Asset class weightings and recommendations are based on values at the end of July 2020. As shown in the charts below, equity markets have now largely recovered most of the March 2020 sell off, albeit this differs by market. For example, the US market is now generally higher than at any time in the last five years, whereas the recovery in the UK market has been much more muted.

(v) Longer Term Performance

Figures provided by Portfolio Evaluation Limited show the Fund's performance over 1, 3, 5 and 10 years to 30 June 2020.

Per annum	**DPF**	**Benchmark Index**
1 year	0.8%	1.1%
3 year	4.2%	4.1%
5 year	7.4%	6.9%
10 year	8.5%	8.2%

The Fund under-performed relative to the benchmark over one year but out-performed the benchmark over all other time periods.

(vi) Category Recommendations

	Benchmark	Fund Allocation	Permitted Range	Recommendation		Benchmark Relative Recommendation	
		31 Jul-20		AF	DPF	AF	DPF
Growth Assets	57.0%	54.6%	± 8%	57.0%	56.0%	-	(1.0%)
Income Assets	23.0%	20.7%	± 6%	25.0%	21.0%	+2.0%	(2.0%)
Protection Assets	18.0%	18.1%	± 5%	16.0%	17.9%	(2.0%)	(0.1%)
Cash	2.0%	6.6%	0 – 8%	2.0%	5.1%	-	+3.1%

At an overall level, the Fund was overweight Protection Assets and Cash at 31 July 2020, and underweight Growth Assets and Income Assets, although if commitments waiting to be drawn down were taken into account, the Fund would move to an overweight position in Growth and Income Assets. The table on page 2 assumes that all new commitments will be funded out of the current cash weighting; in practice as private market commitments are drawn down they are likely to be funded partially out of cash and partially by distributions (income and capital) from existing investments and sales of public market assets. The Fund has progressively reduced its exposure to Growth Assets over the last two years, as equity valuations have become increasingly stretched, and increased the allocation to Income Assets and Protection Assets.

The IIMT recommendations reflected in this report: increase Growth Assets by 1.4% to 56.0% (1.0% underweight), with a change in the regional composition to reflect the implementation of the allocation to sustainable equities: United Kingdom Equities +0.7%; North American Equities -0.2%; European Equities -0.4%; Emerging Markets +0.4%; and Global Sustainable Equities +0.8%; increase Income Assets by 0.3% (Infrastructure +0.2% and Multi-Asset Credit +0.1%); reduce Protection Assets by 0.2% (Index-Linked Bonds -0.2%); and reduce Cash by -1.5%. The IIMT notes that the recommendations are subject to market conditions, which continue to be volatile. The IIMT continues to recommend a defensive cash allocation, reflecting both the general market uncertainty and cash held to fund existing commitment drawdowns.

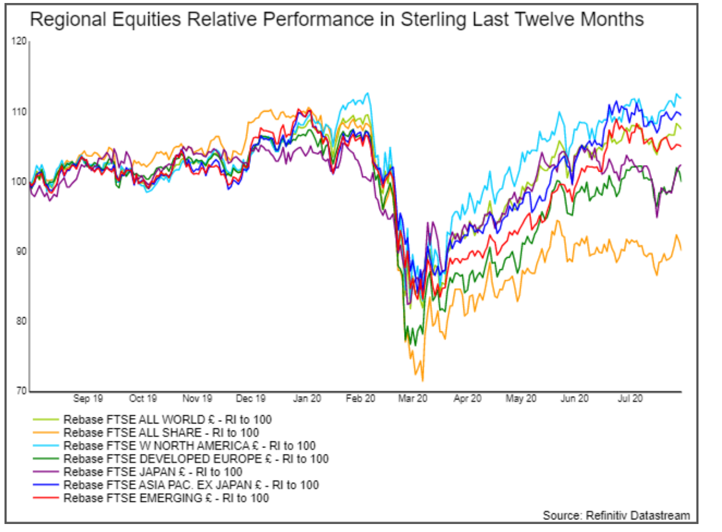
Growth Assets

At 31 July 2020, the overall Growth Asset weighting was 54.6%, up from 53.2% at 30 April 2020, reflecting relative market strength. The IIMT recommendations below increase the weighting to 56.0%; 1.0% underweight (listed equities -0.2% and private equity -0.8%).

Equity markets recovered sharply in Q2 2020 following the Q1 sell-off. The FTSE All World in Sterling terms fell by -16.0% in Q1, and increased by +19.8% in Q2 2020. Equity markets have been more subdued in Q3 2020 to date, albeit with bouts of sizeable market volatility (FTSE All World +2.5% quarter-to-date).

The IIMT believes that a small underweight position of 1.0% in Growth Assets is justified because the recovery from the Covid 19 pandemic is unlikely to be straight even and equity markets appear to be ignoring significant headwinds including: considerable uncertainty about the shape of the economic recovery; whether economic activity can return to pre-outbreak levels; rising new cases and localised lockdowns; no guarantee that a vaccine will be developed (until there is a vaccine restrictions are likely to be periodically ramped up and down); a re-escalation of US-China tensions; and the uncertainty caused by an upcoming US Presidential Election.

The Chart opposite shows the relative regional equity returns in Sterling terms over the last twelve months, and the charts overleaf show the returns since the last Investment Report was presented to Committee and in Q2 2020. Equity markets trended upwards throughout 2019 but fell sharply in February and early March 2020 as the coronavirus outbreak escalated and lockdown measures were introduced across the globe. Markets recovered strongly in April and May 2020, driven by



Benchmark Return	Q3 2020 (*)	Q2 2020	1 Year	3 Year	5 Year
FTSE All World	2.5%	19.7%	5.7%	8.4%	12.3%
FTSE UK	0.3%	10.2%	(13.0%)	(1.6%)	2.9%
FTSE North America	3.0%	21.9%	10.9%	12.5%	15.8%
FTSE Europe	2.1%	18.8%	0.6%	3.6%	8.7%
FTSE Japan	(0.4%)	12.2%	6.8%	4.9%	9.0%
FTSE Asia Pacific Ex-Japan	3.8%	19.8%	2.8%	5.0%	9.8%
FTSE Emerging Markets	3.5%	18.9%	(0.4%)	4.6%	8.0%

Source: Performance Evaluation Limited

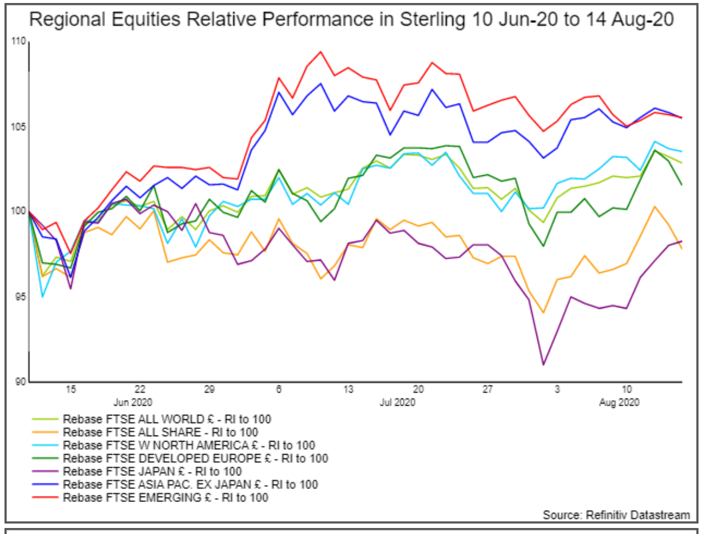
(*) 1 July 2020 to 14 August 2020

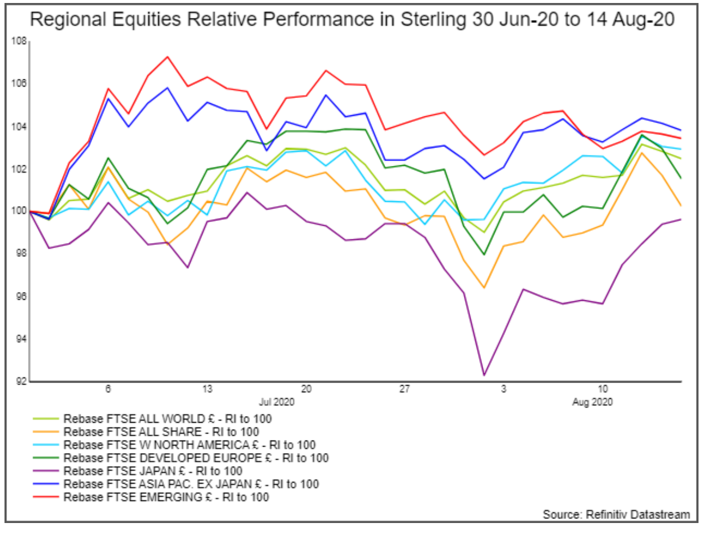
unprecedented levels of fiscal stimulus and a gradual easing of lockdown restrictions as the number of new cases fell in developed markets.

In the year to 14 August 2020, the US market provided the strongest returns (+6.2%) in local currency terms, followed by Asia Pacific Ex-Japan (+3.6%). The UK market produced the lowest return (-17.3%).

Sterling investors benefited from a weaker pound over the period, which pushed up regional equity returns. This increased the US return from +6.2% in local currency to +7.3% in Sterling terms.

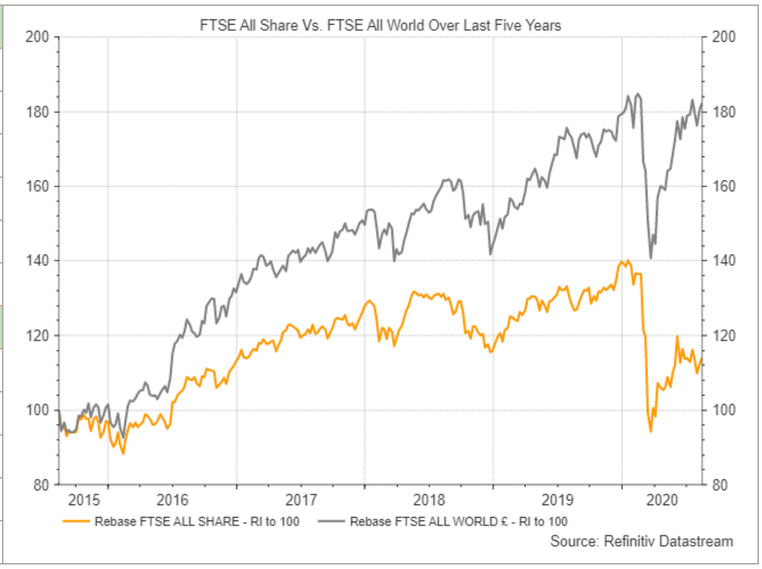
UK Equities lagged all other regional markets in the year to 14 August 2020 due to a longer and more problematic Covid 19 lockdown than many peers, the impact of Brexit uncertainty, and the fact that the UK index has a high concentration of energy and commodity stocks (i.e. some of the sectors most affected by the pandemic), and a low concentration of technology stocks (e.g. some of the companies best positioned to benefit from the Covid 19 pandemic).





United Kingdom Equities

DPF Weightings	
Neutral	16.0%
Actual 31.7.20	15.3%
AF Recommendation	16.0%
IIMT Recommendation	16.0%
Benchmark Returns (GB£)	
Q2 20/21 to 14 Aug-20	0.3%
Q1 20/21	10.2%
1 Year to Jun-20	(13.0%)
3 Years to Jun-20 (pa)	(1.6%)
5 Years to Jun-20 (pa)	2.9%



Relative market weakness reduced the UK Equity allocation from 15.8% at 30 April 2020 to 15.3% at 31 July 2020; 0.7% underweight.

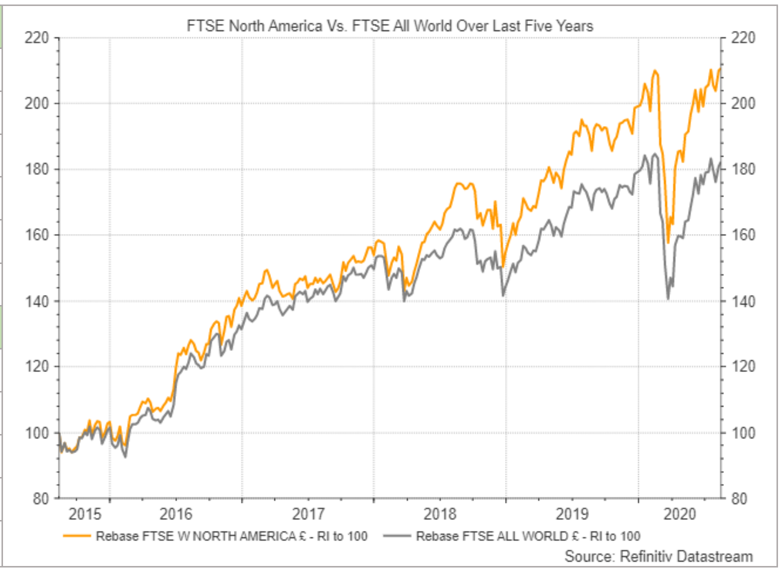
Mr Fletcher recommends a neutral weighting across all of the Fund's regional equity allocations. Mr Fletcher notes that the recovery in equity markets has so far been driven by the unprecedented monetary and fiscal stimulus measures and better than expected high frequency data (time series economic data including consumption, retail sales, employment, inflation, etc.). The risk for markets from here is that the number of new cases is increasing as the level of actively in the economy increases. This is leading to new restrictions on activity and a slowing of the pace of coming out of lockdown, which further weakens and extends the earnings recovery. Mr Fletcher continues to believe that over the next 12 to 18 months the Fund could be presented with the opportunity to adjust the regional allocations and maybe even move overweight in Growth Assets. However, at the present time, with the current level of uncertainty, maintaining a neutral or even slightly underweight position relative to the strategic benchmark may be the most prudent action.

UK GDP fell by -20.4% qoq (which hides a bigger peak to trough fall of -25.6% between February and April 2020), with the majority of the fall to date being borne by the UK government and businesses. Whilst daily new cases appear to have stabilised (albeit with localised outbreaks) and lockdown measures are being gradually relaxed, the end of the government's job furlough scheme is likely to see unemployment rise and place pressure on household income. Consensus Forecasts for August 2020, forecast that the UK economy will shrink by 9.9% in 2020, before recovering by 6.4% in 2021.

The IIMT believes that whilst UK Equity returns are likely to be volatile in the short-term as the uncertainty caused by the Covid19 pandemic and on-going Brexit negotiations weigh on investor confidence, UK equity valuations are attractive on a relative basis, albeit short to medium term earnings forecast are significantly reduced. The IIMT notes that UK Equities also pay a higher dividend than most other regional equity markets, albeit these are likely to be lower in the short to medium terms as companies preserve cash (176 companies have cancelled pay-outs altogether and 30 have reduced the amount payable) and around 70% of the earnings of the UK market are generated overseas increasing diversification. As a result, the IIMT recommends increasing the allocation by 0.7% to a neutral allocation of 16.0%.

North American Equities

DPF Weightings	
Neutral	12.0%
Actual 31.7.20	11.2%
AF Recommendation	12.0%
IIMT Recommendation	11.0%
Benchmark Returns (GB£)	
Q2 20/21 to 14 Aug-20	3.0%
Q1 20/21	21.9%
1 Year to Jun-20	10.9%
3 Years to Jun-20 (pa)	12.5%
5 Years to Jun-20 (pa)	15.8%



There were no transactions in the period and relative market strength increased the weighting from 10.6% at 30 April 2020 to 11.2% at 31 July 2020; 0.8% underweight.

Mr Fletcher recommends a neutral weighting across all of the Fund's regional equity allocations; 12% in respect of North American Equities.

The IIMT notes that the US equity market has recovered sharply since the March 2020 sell off, and is now close to an all-time high. US Equities in local currency terms have returned 3.9% YTD, and 12.4% over the twelve months to 31 July 2020. The Q2 2020 earnings season was considered to be positive, with over 80% of companies reporting actual earnings in excess of expectations.

The YTD recovery has largely been concentrated in a handful of large-cap technology and online retail stocks (Facebook +23.6%; Apple +44.7%; Alphabet (Google) +11.0%; Amazon +71.3%; Netflix +51.1%; and Microsoft +30.0%), significantly increasing the concentration risk of the US equity market. These businesses have business models which have been well suited to the coronavirus outbreak, and there is significant performance dispersion versus the rest of the US market.

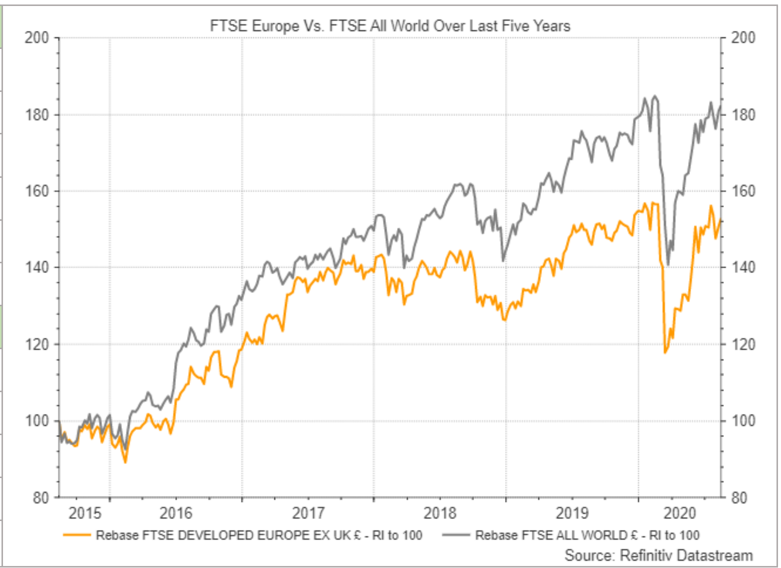
The IIMT believes that the shape of the economic recovery from the Covid 19 pandemic is uncertain. Daily new cases in the US have been rising since mid-June 2020 (albeit the number of new daily deaths is lower now than at its peak), and some localised lockdown restrictions have been reintroduced. Whilst there are early signs that the rate of new cases are starting to stabilise, the impact on US consumer and business confidence is unclear.

It is worth noting that consumer incomes have so far been protected by support measures from the US government which provided $1,200 stimulus cheques as well as a $600 per week boost to unemployment benefits. These payments ceased at the end of July 2020, and although President Trump has since signed an executive order to provide unemployed workers with a $400 a week extra payment, the long term sustainability of these payments is unclear. Furthermore, trade tensions between the US and China continue to escalate, and political uncertainty is also likely to rise in the run-up to the US Presidential Election in November 2020.

Given the strong relative performance of the US Equity market over the last twelve months, the IIMT continues to believe that an underweight position remains justified, and recommend a 1.0% underweight allocation of 11.0%.

European Equities

DPF Weightings	
Neutral	8.0%
Actual 31.7.20	8.4%
AF Recommendation	8.0%
IIMT Recommendation	8.0%
Benchmark Returns (GB£)	
Q2 20/21 to 14 Aug-20	2.1%
Q1 20/21	18.8%
1 Year to Jun-20	0.6%
3 Years to Jun-20 (pa)	3.6%
5 Years to Jun-20 (pa)	8.7%



Whilst there were no transactions in the period, relative market strength increased the Fund's allocation to European Equities to 8.4% at 31 July 2020; 0.4% overweight.

Mr Fletcher recommends a neutral weighting across all of the Fund's regional equity allocations; 8% in respect of European Equities.

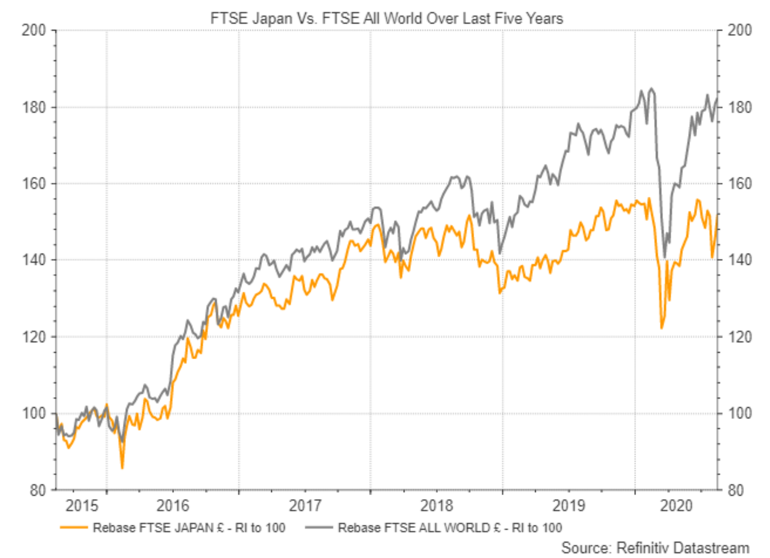
A large part of Europe appeared to have managed the Covid 19 outbreak better than any other region in Q2 2020, although there are growing concerns about a second wave of infections as lockdown restrictions have been eased. Economic activity has been recovering across the region, particularly in Germany, where new infections have been low for several months. However, recent outbreaks across numerous European countries, have come at the peak of the summer tourist season, casting some doubt on the potential for a swift economic recovery.

Eurozone GDP fell by -12.1% in Q2 2020 (the largest quarterly fall in the Eurozone's history), and there were some sizeable regional variances: Spain was the hardest hit, suffering an -18.5% contraction compared to -10.1% in Germany. In response to the crisis, the European Union agreed a €750bn Recovery Fund (aid packages), and the European Central Bank's Pandemic Emergency Purchase Programme (an asset purchase programme) was increased to €1,350b; these stimulus programmes increased the demand for European assets. European Equities returned 7.7% in local currency terms in the three months to 31 July 2020; -4.0% YTD.

The IIMT notes that the economic backdrop in the Eurozone was weak even before the Covid 19 pandemic despite continued monetary support. Whilst the finalisation of the Recovery Fund is positive, and points to further fiscal integration across the European Union, several countries have been badly impacted by the Covid 19 pandemic, and the ongoing outbreak of new localised infections, means that the shape of the economic recovery across Europe is unclear. As a result, the IIMT recommends that the current allocation of 8.4% is trimmed back to a neutral weight of 8.0%.

Japanese Equities

DPF Weightings	
Neutral	5.0%
Actual 31.7.20	5.6%
AF Recommendation	5.0%
IIMT Recommendation	5.6%
Benchmark Returns (GB£)	
Q2 20/21 to 14 Aug-20	(0.4%)
Q1 20/21	12.2%
1 Year to Jun-20	6.8%
3 Years to Jun-20 (pa)	4.9%
5 Years to Jun-20 (pa)	9.0%



Net divestment of £32m (switched into Global Sustainable Equities), together with relative market weakness, reduced the Fund's weighting in Japanese Equities to 5.6% at 31 July 2020; 0.6% overweight against the benchmark.

Mr Fletcher recommends a neutral weighting across all of the Fund's regional equity allocations; 5% in respect of Japanese Equities.

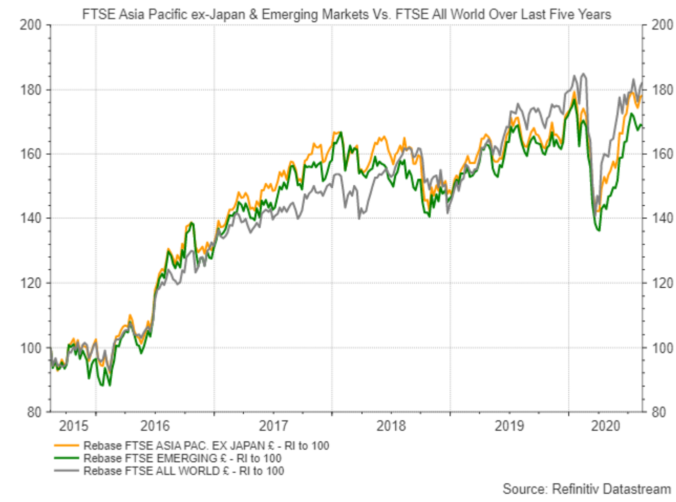
Similar to the Eurozone, the Japanese economy was suffering from weakness prior to the Covid 19 pandemic, and fell into recession in Q1 2020 with a 2.2% contraction. The economy fell by a further 27.8% (annualised) in Q2 2020, wiping-out the benefits brought by Prime Minister Abe's 'Abenomics' stimulus policies employed since late 2012. Consensus forecasts for August 2020, expect the Japanese economy to contract by -5.3% in 2020, before growing by +2.5% in 2021. Similar to other developed markets, the Japanese government has provided significant levels of financial stimulus in response to the pandemic.

Notwithstanding the 2019-20 economic slowdown, the IIMT believes that the long term story in Japan remains intact supported by attractive relative valuations, improving corporate governance, and the diversifying and defensive qualities of the Japanese market (e.g. the safe-haven status of the ¥). Furthermore, Japan has a low reliance on tourism, safe banks, healthy corporate balance sheets and high levels of fiscal stimulus which should help the Japanese economy to recover more quickly from the pandemic by international standards.

The IIMT believes that an overweight position remains appropriate and recommend that the current allocation 5.6% is maintained.

Asia Pacific Ex-Japan and Emerging Market Equities

DPF Weightings	Asia-Pac	EM
Neutral	4.0%	5.0%
Actual 31.7.20	4.2%	4.6%
AF Recommendation	4.0%	5.0%
IIMT Recommendation	4.2%	5.0%
Benchmark Returns (GB£)	**Asia-Pac**	**EM**
Q2 20/21 to 14 Aug-20	3.8%	3.5%
Q1 20/21	19.8%	18.9%
1 Year to Jun-20	2.8%	(0.4%)
3 Years to Jun-20 (pa)	5.0%	4.6%
5 Years to Jun-20 (pa)	9.8%	8.0%



Divestment of £34m into market strength reduced the Fund's allocation to Asia Pacific Ex-Japan Equities to 4.2% at 31 July 2020. There were minimal net transactions in respect of Emerging Market Equities but relative market strength increased the Fund's allocation to 4.6% at 31 July 2020.

Mr Fletcher recommends a neutral weighting across all of the Fund's regional equity allocations; 4% in the case of Asia Pacific Ex-Japan and 5% in Emerging Market Equities.

The IIMT continues to believe in the long-term growth potential of these regions, noting that these regions have accounted for well over half of global growth over the last ten years, and as shown below, Asia Pacific is forecast to grow at a faster rate than developed markets in 2020 and 2021.

Region	Real GDP 2019 (A)	Real GDP 2020 (F)	Real GDP 2021 (F)
Asia Ex-Japan	4.0%	(1.2%)	5.8%
Latin America	0.6%	(8.0%)	4.0%
Eastern Europe	2.4%	(5.0%)	4.2%
North America	2.2%	(5.3%)	4.1%
Japan	0.7%	(5.3%)	2.5%
Eurozone	1.3%	(7.9%)	5.7%
United Kingdom	1.5%	(9.9%)	6.4%

Source: August 2020 Consensus Forecasts

Notwithstanding the strong growth dynamics, particularly in respect of Emerging Asia, this has failed to convert into strong relative returns for emerging market investors. Over the last five years to July 2020, Asia Pacific and Emerging Market equity returns have been relatively weak; cumulative total dollar returns from US equities totalled 102.8%, compared to 67.3% from Asia Pacific equities and 60.7% from emerging market equities.

The poor relative performance of Asia Pacific Ex-Japan and Emerging Market Equities has been attributed to three key drivers: a stronger dollar acting as a headwind for further migration of western savings pools towards these regions; tepid global growth, including an on-going slowdown in China; and the increase in more domestically focused political agendas (e.g. at the expense of further globalization).

The economic impact of the Covid 19 pandemic remains unclear, albeit the consensus forecasts for the Asia Pacific region appear positive and the response from most of the countries in the region to the coronavirus outbreak was seen as timely and decisive, and the lockdown measures introduced have now been largely relaxed. Furthermore, there are growing signs that the tensions between the US and China are escalating again, and there is a risk that following the pandemic, political agendas and supply chains will become much more domestically focused (e.g. at the expense of further globalisation).

The IIMT recommends holding the Asia Pacific Ex-Japan Equity weighting at 4.2% (0.2% overweight), whilst adding 0.4% to Emerging Market's to also bring it into line with a neutral weighting of 5%.

Global Sustainable Equities

DPF Weightings	
Neutral	3.0%
Actual 31.7.20	2.2%
AF Recommendation	3.0%
IIMT Recommendation	3.0%
Benchmark Returns (GB£)	
Q2 20/21 to 14 Aug-20	2.5%
Q1 20/21	19.7%
1 Year to Jun-20	5.7%
3 Years to Jun-20 (pa)	8.4%
5 Years to Jun-20 (pa)	12.3%

Net investment in the three months to 31 July 2020 totalled £68m, taking the asset class weighting to 2.2% at end of July 2020.

Mr Fletcher recommends a neutral weighting across all of the Fund's regional equity allocations; 3% in respect of Global Sustainable Equities.

The IIMT expects to allocate further capital to the asset class over the next quarter subject to market conditions, and to move towards a neutral weighting of 3%.

Private Equity

DPF Weighting					
Netural		Actual 31.7.20	Committed 31.7.20	AF Recommendation	IIMT Recommendation
4.0%		3.1%	4.9%	4.0%	3.2%
Benchmark Returns (GB£)					
Q2 20/21 to 14 Aug-20	Q1 20/21	1 Year to Jun-20	3 Years to Jun-20 (pa)	5 Years to Jun-20 (pa)	
0.4%	10.3%	(12.0%)	(0.6%)	3.8%	

The Private Equity weighting fell from 3.2% at 30 April 2020 to 3.1% at 31 July 2020 reflecting the flow through of March 2020 valuation reports incorporating the valuation impact of the Covid 19 pandemic.

Mr Fletcher recommends a neutral weighting of 4% in Private Equity.

The IIMT believes that the coronavirus outbreak is likely to lead to a period of lower private equity multiples, particularly in respect of small and mid-cap deals, and note that the Fund's outstanding private equity commitments should be well positioned to benefit from these opportunities. The IIMT recommends that the Private Equity weighting is increased by 0.1% to 3.2% (0.8%% underweight) in the forthcoming quarter, in anticipation of existing commitment drawdowns.

(vii) Income Assets

At 31 July 2020, the overall weighting in Income Assets was 20.7%, down from 21.3% at 30 April 2020, principally reflecting relative market weakness compared to growth assets. The IIMT recommendations below would take the overall Income Asset weighting to 21.0%, and the committed weighting to 24.7%.

Multi Asset Credit

DPF Weighting				
Neutral		Actual 31.7.20	AF Recommendation	IIMT Recommendation
6.0%		6.1%	8.0%	6.2%
Benchmark Returns (GB£)				
Q2 20/21 to 14 Aug-20	Q1 20/21	1 Year to Jun-20	3 Years to Jun-20 (pa)	5 Years to Jun-20 (pa)
3.5%	6.5%	(0.3%)	2.3%	n/a

There were minimal net transactions in the three months to 31 July 2020, with commitment drawdowns being matched by distributions, and the asset class weighting stayed at 6.1%. Adjusting for commitments, the weighting increases to 7.7%. Whilst this implies the pension fund will be 1.7% overweight should all the commitments be drawn-down, in practice it is unlikely that the commitments will be fully drawn, and some of the existing closed-ended investments have now entered their distribution phase (i.e. returning cash to investors).

Mr Fletcher continues to recommend a 2% overweight allocation to Multi-Asset Credit believing that the main opportunity comes from global high yield bonds, emerging debt, loans and the dynamic allocation between these sectors of the bond market. Mr Fletcher notes that whilst spreads have narrowed significantly since March 2020, central banks remain determined to support the markets through bond purchases and an extended period of low policy rates and government bond yields. As always with this type of asset avoiding the risk of default is the key to success, but even at the current level of spread, Mr Fletcher believes that sub-investment grade assets appear attractive despite the increased risk of default.

Whilst the IIMT continues to be positive about the long-term attractions of the asset class, with a strong bias towards defensive forms of credit, it is noted that spreads have narrowed significantly since mid-March 2020 (e.g. US 7-10 year high yield bond spreads initially increased from around 375 basis points prior to the outbreak to around 1,100 basis points by mid-March but have subsequently fallen to around 500 basis points). The IIMT believes that it is unclear whether the current level of spread is sufficient to compensate for the increased risk of default, particularly when the shape of the economic recovery is unclear, and the recovery cannot easily be benchmarked to previous trends. It is also likely to differ significantly by country and sector.

The IIMT recommends increasing the invested weighting by 0.1% to 6.2% in the upcoming quarter (0.2% overweight) to cover anticipated commitment drawdowns.

Property

DPF Weighting				
Neutral		Actual 31.7.20	AF Recommendation	IIMT Recommendation
9.0%		7.8%	9.0%	7.8%
Benchmark Returns (GB£)				
Q2 20/21 to 14 Aug-20	Q1 20/21	1 Year to Jun-20	3 Years to Jun-20 (pa)	5 Years to Jun-20 (pa)
Not Available	(2.2%)	(2.7%)	3.0%	4.6%

The Fund's allocation to Property fell by 0.5% to 7.8% at 31 July 2020. Direct Property accounted for 4.5% (0.5% underweight) and Indirect Property accounted for 3.3% (0.7% underweight). The committed weight was 8.0% at 31 July 2020.

Mr Fletcher recommends that the property allocation remains neutral overall. The uncertainty over the future use of buildings created by Covid-19 has increased the potential volatility of returns from the asset class. Certain types of buildings my need to be re-purposed, at a minimum property could see a medium term downward re-rating and the income generated from rents could have an impact beyond the short-term. Mr Fletcher notes that as a long-term investor, the Fund can afford to 'look-through' the volatility and low yield environment, and property probably remains an attractive asset class.

Colliers Capital, the Fund's Property Manager, note that the coronavirus pandemic has had a dramatic and unprecedented effect on the economic health of the UK and in turn the UK commercial property market. The retail and leisure sectors have been particularly badly affected with many businesses being closed down during the lockdown. Rent collection has been a significant issue for landlords during this time. The Fund's portfolio continues to perform well relative to the benchmark, with a total return of -

2.0% in Q2 2020, versus a benchmark return of -2.2% (last twelve months +0.4% versus -2.7%). The current portfolio void rate is 6.0%, versus a benchmark void rate of 7.6%. The focus now is largely on additional investment into the industrial sector. In light of the effect of the coronavirus on the retail and leisure sector, further investment in those areas is unlikely at present.

The IIMT recommends that in the short term the Fund's current allocation to Direct Property (4.5%; 0.5% underweight) and Indirect Property (3.3%; 0.7% underweight) are maintained but liquidity of up to £50m is made available to the Direct Property manager to make further investments at the right time should they identify suitable investment opportunities.

Infrastructure

DPF Weighting					
Neutral		Actual 31.7.20	Committed 31.7.20	AF Recommendation	IIMT Recommendation
8.0%		6.8%	9.0%	8.0%	7.0%
Benchmark Returns (GB£)					
Q2 20/21 to 14 Aug-20	Q1 20/21	1 Year to Jun-20	3 Years to Jun-20 (pa)	5 Years to Jun-20 (pa)	
0.3%	0.6%	2.7%	2.7%	2.5%	

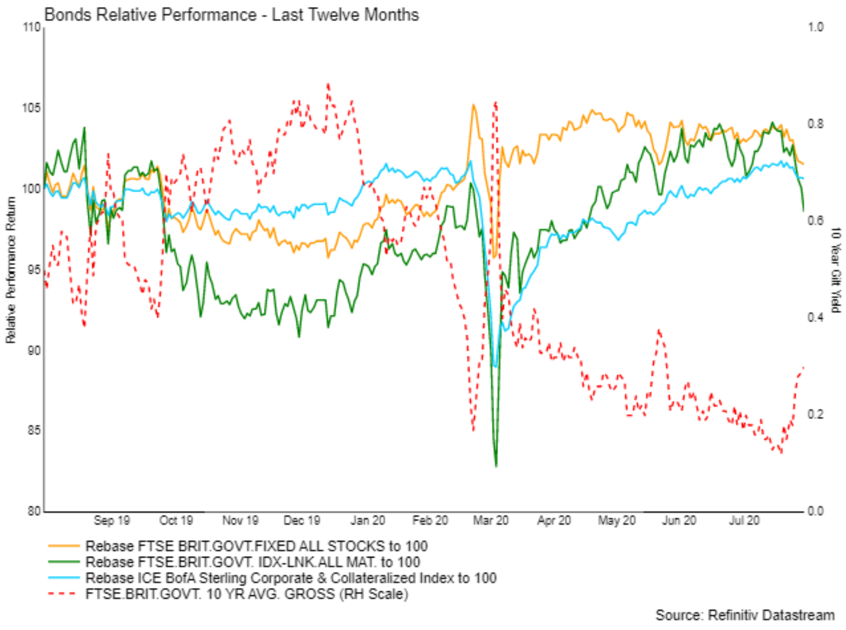
Relative market weakness reduced the Fund's allocation to Infrastructure from 6.9% at 30 April 2020 to 6.8% at 31 July 2020; 9.0% on a committed basis.

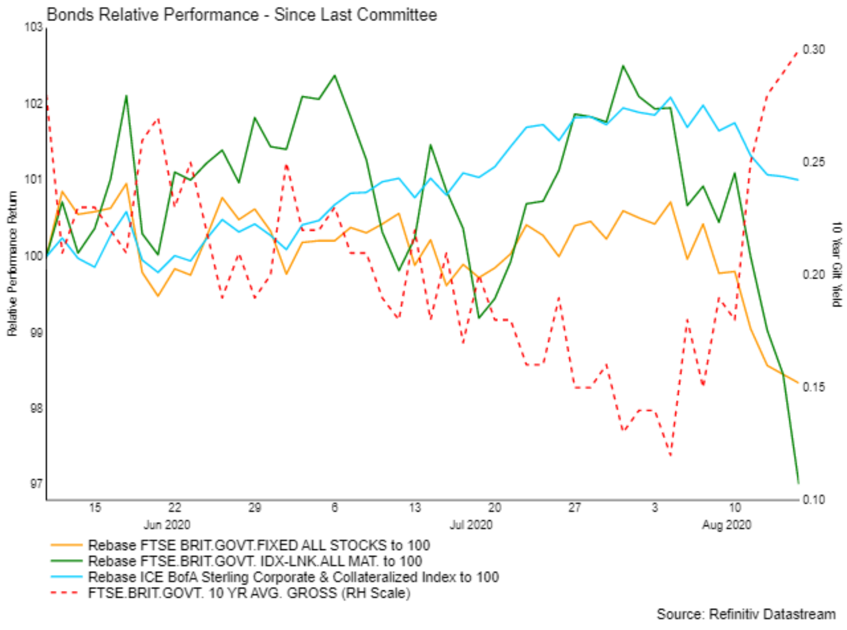
Mr Fletcher recommends a neutral weighting of 8% allocation.

The IIMT continues to view Infrastructure as an attractive asset class, and favours a bias towards core infrastructure assets. Core infrastructure assets can offer low volatility; low correlation to equity and fixed income; and reliable long-term cash flows. Notwithstanding the noted favourable characteristics of the asset class, the IIMT continues to believe that infrastructure assets are exposed to increased political and regulatory risk, and this risk is managed through asset type and geographical diversification. Further investment opportunities, which are in line with these objectives, continue to be assessed, including a focus on additional renewable energy commitments.

The IIMT recommends that the Infrastructure weighting is increased by 0.2% to 7.0% (1.0% underweight) in the next quarter, in anticipation of existing commitment draw-downs.

(ix) Protection Assets



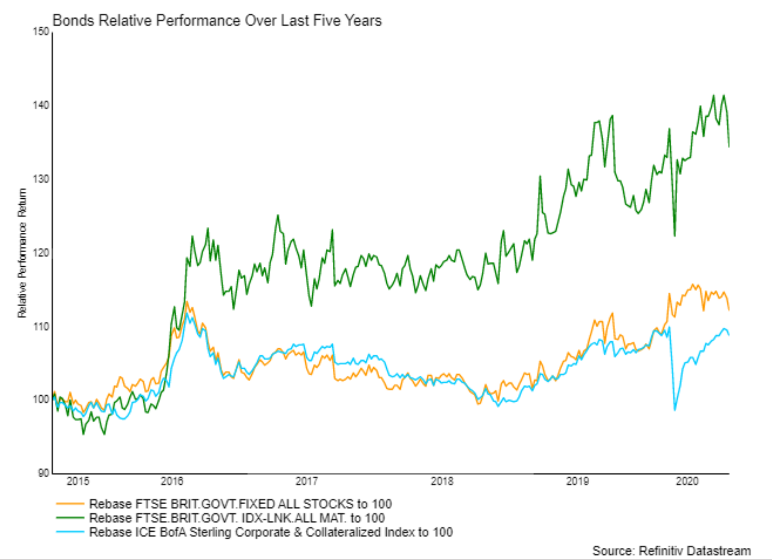


The weighting in Protection Assets at 31 July 2020 was 18.1%, down from 18.3% at 30 April 2020, reflecting relative market weakness. The IIMT recommendations below reduce the weighting to 17.9%.

Government bond yields gradually fell (i.e. prices rose) in June and July before rallying slightly in August 2020. Bond yields have not risen despite the equity market rally since mid-March 2020, and the expectations of significant bond issuance going forward. G7 yields remain near historic lows, consistent with expectations for a prolonged period of zero-or-below policy rates in response to the economic backdrop.

Conventional Bonds

DPF Weightings	
Neutral	6.0%
Actual 31.7.20	5.5%
AF Recommendation	3.0%
IIMT Recommendation	5.5%
Benchmark Returns (GB£)	
Q2 20/21 to 14 Aug-20	(1.8%)
Q1 20/21	2.5%
1 Year to Jun-20	11.2%
3 Years to Jun-20 (pa)	5.9%
5 Years to Jun-20 (pa)	6.0%



There were no transactions in the period, and relative market weakness reduced the Fund's allocation to Conventional Bonds by 0.3% to 5.5% at 31 July 2020; 0.5% underweight.

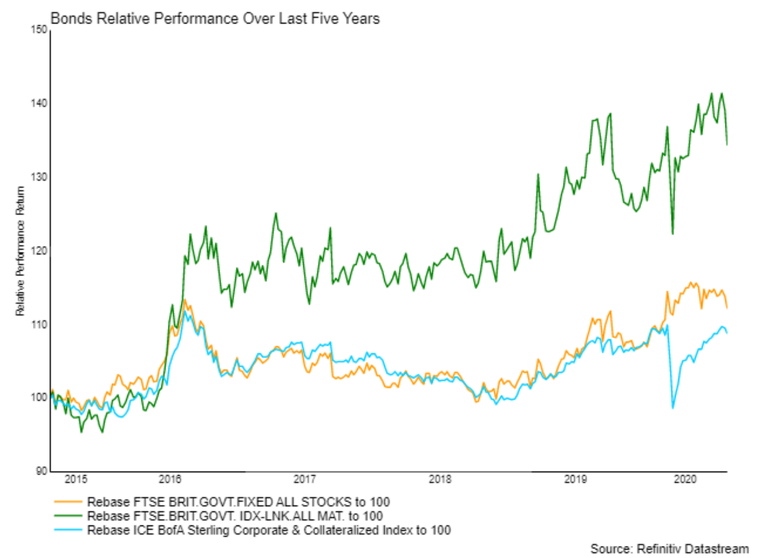
Mr Fletcher has maintained his recommended allocation to Conventional Bonds at 3% (3% underweight) noting that government bond yields have continued to fall, making new 'All Time Lows' as markets have responded to the Covid19 pandemic. Mr Fletcher expects government bond yields to remain around their current levels for a long time, and does not expect central bank policy rates to change for the next 12 to 18 months. Over the long term, Mr Fletcher does expect government bond yields to rise and there is the risk that yield curves could steepen if inflation becomes more of a concern, but for now central banks will do all they can to keep government yields at or close to their current levels.

The IIMT continues to believe that whilst conventional sovereign bonds do not appear to offer good value at current levels with yields around historic lows, they are diversifying assets and continue to afford greater protection than other asset classes in periods of market uncertainty as evidenced during the Covid 19 pandemic (+7.0% year to 14 August 2020, 3.8% higher than the FTSE All World).

The IIMT recommends that the current 0.5% allocation of 5.5% is maintained.

Index-Linked Bonds

DPF Weightings	
Neutral	6.0%
Actual 31.7.20	6.2%
AF Recommendation	6.0%
IIMT Recommendation	6.0%
Benchmark Returns (GB£)	
Q2 20/21 to 14 Aug-20	(4.3%)
Q1 20/21	10.3%
1 Year to Jun-20	10.6%
3 Years to Jun-20 (pa)	6.9%
5 Years to Jun-20 (pa)	8.4%



The Fund's allocation to Index-Linked Bonds remained flat at 6.2% between 30 April 2020 and 31 July 2020; 0.2% overweight.

Mr Fletcher recommends a neutral 6% allocation to Index-Linked Bonds (Linkers), with a preference to remain 2% underweight UK Index-Linked Bonds and 2% overweight US Treasury Inflation Protected (TIPS) Bonds. Mr Fletcher notes that whilst the real yield on TIPS has fallen over the last quarter, UK Index Linked yields have fallen further, meaning that there is still a yield pick-up for holding TIPS, and the US market is not subject to the potential change in the calculation of the inflation measure used to uplift coupon and principal repayments. The consultation on the proposed changes to the method of calculating the RPI measure of inflation closes in August 2020. Mr Fletcher notes that UK Index Linked market has only priced in about 50% of the potential impact of the change to the inflation measure on the market valuation of UK inflation protected bonds. Whilst asset managers continue to lobby for no change to the inflation measure or compensation, corporate Pension Fund trustees with RPI liabilities appear more relaxed about the proposed change. Mr Fletcher notes that there is an increasing consensus that the Chancellor will endorse the change in the Autumn Budget Statement without compensation to bond holders.

In line with the IIMT's recommendation in respect of Conventional Bonds, the IIMT notes that whilst Index-Linked Bonds appear expensive at current levels, it is too early to call the bottom of the Covid 19 pandemic. The IIMT believes that inflation expectations in the short-term are muted reflecting the deflationary effects of weaker demand and lower oil prices but in the medium term inflation is likely to pick-up driven by the enormous policy stimulus (both fiscal and monetary) and tighter global supply chains. The IIMT recommends a 6% neutral allocation to Index-Linked Bonds, and that the current exposure to US TIPS (around 20% of the Index-Linked portfolio) is maintained.

Corporate Bonds

DPF Weightings	
Neutral	6.0%
Actual 31.7.20	6.4%
AF Recommendation	7.0%
IIMT Recommendation	6.4%
Benchmark Returns (GB£)	
Q2 20/21 to 14 Aug-20	1.6%
Q1 20/21	8.5%
1 Year to Jun-20	9.2%
3 Years to Jun-20 (pa)	5.1%
5 Years to Jun-20 (pa)	5.2%

Relative market strength increased the Fund's allocation to the asset class from 6.3% at 30 April 2020 to 6.4% at 31 July 2020; 0.4% overweight.

Mr Fletcher has maintained is 1% overweight allocation to Corporate Bonds noting that the recent rise in credit spreads is more than sufficient to compensate for the additional default risk.

The IIMT notes that credit spreads have narrowed significantly since mid-March 2020 (e.g. US 7-10 year investment grade bond spreads initially increased from around 100 basis points prior to the outbreak to around 400 basis points by mid-March but have subsequently fallen to around 130 basis points), and it is unclear whether the current level of spread is sufficient to compensate for the increased default, particularly when the shape of the recovery is unknown, and the recovery cannot easily be benchmarked to previous trends. It is also likely to differ significantly by country and sector, and there is an increased risk of 'zombie' companies (companies weighed down by debt who are keep going by low interest rates/banks' unwillingness to recognise the write down that would be associated with an insolvency). Whilst the impact of the current situation on corporate profitability, balance sheets and cash flows remains unclear, the IIMT believes that the more modest overweight allocation of 6.4% is warranted.

(x) Cash

The Cash weighting at 31 July 2020 was 6.6% (4.6% overweight relative to the benchmark).

Mr Fletcher has maintained his 2% neutral allocation to Cash but notes that a sizeable proportion of this is already promised to future investments (i.e. existing contractual commitments). Mr Fletcher notes that given the current level of uncertainty a higher cash balance remains a good strategy for the Fund.

Global markets have recovered following the sharp sell-off in Q1 2020, but this has been heavily dependent on substantial and unprecedented central bank monetary support. The recovery from the Covid 19 pandemic is likely to be uneven, and markets appear to be ignoring significant headwinds including considerable uncertainty about the shape of the economic recovery; whether economic activity can return to pre-outbreak levels; rising new cases and localised lockdowns; no guarantee that a vaccine will be developed (until there is a vaccine restrictions are likely to be ramped up and down occasionally); a re-escalation of US-China tensions; and the uncertainty caused by an upcoming US Presidential Election.

The IIMT recommends a defensive cash allocation of 5.1% due to the highly uncertain economic outlook This will also ensure that the Fund has sufficient operational headroom after adjusting for term-loan maturities (i.e. short-term loans provided by the Fund to other public sector bodies) to cover upcoming investment commitment drawdowns (expected to be in excess of £120m over the course of 2020-21), and to cover the likelihood that cash inflows into the Fund, particularly, from investment income, reduce as a result of the Covid 19 pandemic.

3 Other Considerations

In preparing this report the relevance of the following factors has been considered: financial, legal and human rights, human resources, equality and diversity, health, environmental, transport, property and prevention of crime and disorder.

4 Background Papers

Files held by the Investment Section.

5 Officer's Recommendations

5.1 That the report of the external adviser, Mr Fletcher, be noted.

5.2 That the asset allocations, total assets and long term performance analysis in this report be noted.

5.3 That the strategy outlined in the report be approved.

Peter Handford

Director of Finance & ICT